

These commenters appear to have underlying concerns about potential anti-competitive behavior, particularly about the risk of cross-subsidization. We find that NECA should be able to fully compete with other organizations in providing the requested activities as long as NECA's performance of Category I activities does not confer an unfair advantage.

20. *Cost Misallocation:* To minimize the risk of cross-subsidization resulting from the misallocation of costs between Category I and Category II discussed by some commenters,⁵⁶ we condition our authorization of the additional activities as discussed in paragraphs 21 and 22. We find that the accounting requirements we now impose, in addition to those to which NECA is already subject, will enable auditors to determine whether the costs of competitive Category II activities are being misallocated to Category I, which must include only the costs of activities funded by interstate access charges. These safeguards meet the first criterion for authorizing additional activities. Our analysis of each of the requested activities will therefore address only the two remaining criteria.

21. NECA has voluntarily engaged independent auditors to audit its Annual Report of Cost Allocation Results ("Cost Allocation Report") since 1989. We find that, as a condition of our authorization of the requested additional activities, NECA must engage an independent auditor to perform an annual audit of the Cost Allocation Report that will be conducted in accordance with the Professional Standards of the American Institute of Certified Public Accountants ("AICPA")⁵⁷ and such additional procedures as the Common Carrier Bureau may require. Prior to each audit, NECA (or an independent auditor on behalf of NECA) must submit proposed audit procedures to the Bureau and receive affirmative approval of the procedures. The Bureau may require additions to the proposed procedures before approving them. The audit procedures must allow the independent auditor to conclude whether NECA's cost allocations as reported in the Cost Allocation Report are in conformity with, and an accurate application of, the Commission's existing requirements, including those reflected in NECA's CAM.⁵⁸ The annual audit report must be filed with the Cost Allocation Report annually, on or before April 1 of the following year. These requirements will enable the Bureau to target areas of risk and will enhance its ability to monitor NECA's activities.

⁵⁶ See, e.g., GVNW Reply at 1; MCI Opposition at 4-5.

⁵⁷ AICPA Professional Standards, Vol. 1 (American Institute of Certified Public Accountants ed. 1996).

⁵⁸ Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd 1298 (1987) ("Joint Cost Order"), recon., Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Order on Reconsideration, CC Docket No. 86-111, 2 FCC Rcd 6283 (1987), further recon., 3 FCC Rcd 6701 (1988), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990). In interpreting the Commission's requirements, the independent auditors should seek guidance directly from the Commission.

22. With respect to the activities approved in this Order, NECA must comply with the following conditions that have been imposed in previous authorizations of Category II activities: (1) NECA must maintain all records of the costs and revenues of the activities; (2) NECA's annual cost apportionment report must reflect the results of the activities; (3) with the exception of the business evaluation project, each of NECA's activities must cover its own costs fully; and (4) expenses relating to the activities must not be recovered through interstate access charges.⁵⁹

23. *Unfair Competition:* To address the suggestions by commenters that NECA's status as a quasi-governmental entity may confer an unfair competitive advantage,⁶⁰ we require NECA to give all potential customers for its Category II services written notice that NECA is a private corporation and not an arm of the United States government. This notification must be contained in the first correspondence or set of materials conveyed to potential clients, and must be included in all contracts for the provision of Category II services.

24. *Impartiality:* A number of commenters expressed concern that NECA's performance of additional Category II activities may create an appearance of impropriety and may undermine NECA's impartiality in carrying out its core functions.⁶¹ While we agree that NECA's competitive activities must not jeopardize the integrity of its core functions, commenters do not explain how the additional activities may compromise NECA's neutrality.⁶² To provide clarification for NECA's membership, however, we adopt NECA's proposal to give those potential customers of Category II services that have contact with NECA as a result of its Category I activities written disclosure that purchase of the service will confer no advantage to the purchasers in Category I activities. This disclosure must be contained in the first correspondence or set of materials conveyed to potential Category II clients that are NECA members, and must be included in all contracts for the provision of services to Category II customers that are NECA members.

⁵⁹ Interstate Services Order, DA 88-1610 at paras. 8-9; Non-Member Company Data Order, 11 FCC Rcd at 1142, para. 9; Intrastate Services Order, 2 FCC Rcd at 6853, para. 3.

⁶⁰ CHA Comments at 7; USIN Comments at 6.

⁶¹ CHA Comments at 4; Staurulakis Comments at 7-8; USIN Comments at 3.

⁶² Staurulakis questions how NECA could perform its pooling function in an impartial manner while assisting an individual ILEC in making a management decision that is not in the interests of other ILECs in the pool. Staurulakis Comments at 7. We distinguish this example from the activities authorized in this order because the proposed business management training will only address generic issues such as the performance of written and oral presentations, and does not include individual management consulting. See supra para. 10. Similarly, in discussing potential threats to NECA's neutrality, USIN offers a scenario that also could not arise as a result of this authorization. USIN states that it would be "patently absurd" for NECA to offer interexchange resale services, but this order authorizes no activity of this kind. USIN Comments at 3.

25. *Reducing Category I operating expenses:* NECA represents that revenues resulting from Category II activities that exceed Category II costs will be used to reduce Category I operating expenses. We require that as a condition of performing the additional Category II activities, NECA act consistently with this representation to ensure that NECA's membership, interexchange carriers, and ultimately ratepayers will benefit from authorization of these additional activities.

B. International Assistance

26. NECA requests authorization to provide to international entities on a compensatory basis information and analysis relating to telecommunications access charges, tariffs, revenue distribution, universal service, interconnection, and other activities in which NECA has been authorized to engage.⁶³ NECA has developed expertise in these areas through its performance of Category I activities, and several commenters have stated that there is a demand for this service among international entities.⁶⁴ We therefore find that NECA's provision of international assistance is consistent with the public interest.

27. Some consultants suggest that the proprietary information collected by NECA through its Category I activities may confer an unfair competitive advantage.⁶⁵ While NECA's ability to provide such information to international entities would arguably confer an unfair competitive advantage, NECA is prohibited from releasing proprietary information without an ILEC's written permission, according to the terms of agreements between NECA and ILECs submitting proprietary information.⁶⁶ Furthermore, NECA is prohibited from using such information for any purpose other than the distribution of access charge revenues.⁶⁷ NECA's Financial Policy and Practice statement provides that proprietary information gained through Category I or TRS activities may not be made available for use in Category II activities unless permission is obtained from ILECs submitting such information to NECA and the information is made available to all interested parties.⁶⁸ We therefore find that NECA's access to proprietary information will not enhance its competitive position in providing international assistance. We

⁶³ See supra para. 8.

⁶⁴ IFC Comments at 1; Miller Comments at 1; NTCA Comments at 1-3; USAID Comments at 1.

⁶⁵ CHA Comments at 4; GVNW Reply at 5.

⁶⁶ See Assignment for the Distribution of Interstate Access Revenues, Section VIII, 1984/1985 (sample agreement to be signed by NECA and individual exchange carriers). See also Agreement Not To Disclose Proprietary Information (sample agreement to be signed by NECA and individual NECA employees).

⁶⁷ Id.

⁶⁸ NECA Financial Policy and Practice, No: A-20, Subject: Category II Activities, Sept. 1, 1995.

thus grant NECA's request to provide international assistance because NECA has satisfied the three criteria necessary for obtaining our authorization to engage in the requested activity.

C. Telecommunications-related Training

28. NECA requests authorization to provide, on a compensatory basis, telecommunications-related training on emerging technologies and business management.⁶⁹ NECA's performance of this activity is consistent with the public interest because keeping ILECs informed of changes in technology and updating telecommunications-related management techniques will enable ILECs to offer their customers new technologies and improved services. For the reasons discussed in paragraph 27, we find that NECA's access to proprietary information will not enhance its competitive position in providing telecommunications-related training. We do not agree with commenters who argue that training will distract NECA from its primary mission,⁷⁰ and find instead that the activity may enable NECA to make efficient use of its core operations by drawing on the existing knowledge of NECA personnel. We therefore grant NECA's request to provide telecommunications-related training because NECA has satisfied the three criteria necessary for obtaining our authorization to engage in the requested activity.

D. Evaluation of Potential Activities

29. NECA requests authorization to evaluate potential Category II activities and activities incidental to Category I activities.⁷¹ As proposed by NECA, each evaluation will typically be completed within a one-year period, and annual aggregate expenses for all evaluations should not exceed one percent of annual NECA and INS operating expenses.⁷² In addition, no costs incurred by NECA for evaluating potential Category II activities or incidental Category I activities should be recovered through interstate access charges. We therefore require NECA to treat all such costs as Category II expenses.

30. One commenter has asserted that funding research and development for NECA is difficult to justify because NECA lacks shareholders to bear the risks of loss in competitive areas⁷³ and therefore has an unfair competitive advantage. We find that NECA does not have an unfair competitive advantage because, like its potential competitors, NECA must fund its evaluation of competitive Category II activities either through the revenues of other Category II

⁶⁹ See supra para. 9.

⁷⁰ Interstate Telcom Consulting Comments at 1; Staurulakis Comments at 2-6; USIN Comments at 5, 7-8.

⁷¹ See supra para. 10.

⁷² See supra para. 10.

⁷³ GVNW Reply at 4.

activities or through loans. We will, however, evaluate potential anti-competitive advantages in a specific context if and when NECA requests authorization to engage in a particular activity. Because NECA's performance of additional activities may be consistent with the public interest, as we have determined with regard to the activities addressed in this order, we find that evaluating the feasibility of performing such activities is also consistent with the public interest. We therefore grant NECA's request to evaluate potential Category II activities and activities incidental to Category I activities because NECA has satisfied the three criteria necessary for obtaining our authorization to engage in the requested activities.

31. In our *Joint Cost Order*, we established four quantitative and qualitative tests for determining when we would permit carriers to account for incidental activities as regulated activities.⁷⁴ Activities meeting these tests are determined to pose little threat of harm from cross-subsidization⁷⁵ and create such minimal financial impact that requiring them to be accounted for as nonregulated would be unnecessarily burdensome. Applying the reasoning of the *Joint Cost Order*, we conclude that NECA should apply the following criteria to its incidental activities: each activity must be an outgrowth of NECA's Category I operations and must not constitute a separate line of business. To ensure that the incidental activities are sufficiently minor, the aggregate costs of all of the incidental activities must not exceed one percent of total NECA and INS operating expenses. We do not apply an additional test established in the *Joint Cost Order*, the requirement that the activity historically has been treated as incidental for accounting purposes,⁷⁶ because unlike the carriers subject to the *Joint Cost Order*, NECA does not have a long history of engaging in activities that have been treated as incidental. We may determine at a future date, however, that the threat of harm from cross-subsidization merits the application of other criteria to particular incidental activities.

E. INS Agent and Administrative Activities

32. NECA requests authorization to provide, on a compensatory basis through INS, additional agent and administrative services relating to the marketing of the services of both ILECs and third-party vendors.⁷⁷ Many ILECs state that they have a need for these services.⁷⁸ We therefore find that INS's provision of additional agent and administrative services is consistent with the public interest.

⁷⁴ Joint Cost Order, 2 FCC Rcd at 1308, paras. 76-78.

⁷⁵ See id., 2 FCC Rcd at 1305, para. 56.

⁷⁶ Id. at 1308, para. 78.

⁷⁷ See supra para. 11.

⁷⁸ Benton Comments at 1; Chesnee Comments at 1-2; CST Comments at 1; CTC Comments at 1; MCT Comments at 1.

33. We also find that as a result of its Category I operations, NECA has access to financial and operational information about individual LECs that could confer a direct, significant advantage on INS in these marketing activities. INS could use this proprietary information, which is not available to its competitors, to determine the needs of specific LECs and develop specialized marketing services. Rather than barring INS from all use of proprietary information, as urged by GVNW,⁷⁹ however, we ensure that access to such information is protected and is made available only on a competitively neutral basis by imposing the following requirement.⁸⁰ Employees of INS may not have access to proprietary information received or obtained from any company as a result of NECA's Category I or TRS operations unless prior affirmative written consent is obtained from that company, and the information is made available to any interested parties on reasonable and nondiscriminatory terms. We therefore grant NECA's request to perform the additional agent and administrative services proposed by NECA⁸¹ because NECA has satisfied the three criteria necessary for obtaining our authorization to engage in the requested activities.

IV. ORDERING CLAUSES

34. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), 4(j), 201-205 and 218-220 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), 154(j), 201-205 and 218-220; and Sections 0.91, 0.291 and 69.603 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291 and 69.603, that the request for authorization to perform additional services filed by the National Exchange Carrier Association, Inc. IS GRANTED in accordance with the above discussion.

FEDERAL COMMUNICATIONS COMMISSION

Regina M. Keeney
Chief, Common Carrier Bureau

⁷⁹ GVNW Reply at 5.

⁸⁰ Congress has allowed telecommunications carriers to use, for nonregulated purposes, proprietary information obtained initially through regulated activities, provided certain safeguards are in place. For example, carriers can use aggregate Customer Proprietary Network Information ("CPNI") in their marketing of enhanced services if the information is made available to others upon request. 47 U.S.C. § 222.

⁸¹ See supra para. 11.



United States
General Accounting Office
Washington, D.C. 20548

Office of the General Counsel

B-278820

December 23, 1997

William Kennard
Chairman
Federal Communications Commission
1919 M Street, N.W.
Washington, DC 20554

Dear Mr. Kennard:

In connection with a request from Senator Ted Stevens, we are conducting a review of the Commission's implementation of section 254 of the Communications Act of 1934, as amended (47 U.S.C. 254). Specifically, we have been asked to determine whether the Commission had the legal authority to direct the National Exchange Carrier Association (NECA) to establish a separate subsidiary and two unaffiliated corporations to administer the universal service support mechanisms. Additionally, we have been requested to provide a description of what federal laws, employment rules, and oversight would govern the operation of these corporations. Finally, Senator Stevens has requested that we provide a summary of the pending court actions filed in response to the Commission's Universal Service Order.

We have met with your General Counsel's staff and asked that they review a list of selected Federal statutes and determine if the statutes apply to NECA, its newly formed subsidiary, and the two unaffiliated corporations and to explain the reasons. We have been advised that other questions should be submitted in writing. In order for us to provide Senator Stevens with a briefing in late January, we will need your response to the following questions.

1. In establishing NECA in the first instance, and then in directing NECA to establish a separate subsidiary and two unaffiliated corporations, the Commission has relied on its authority under section 4(i) of the Communications Act, as amended (47 U.S.C. 154(i)). Please explain how this provision provides authority to establish private corporations without specific statutory direction in view of the Government Corporation Control Act. Would the establishment of these corporations be a delegation of authority to private entities?

2. Are NECA, its newly formed subsidiary, or the two unaffiliated corporations, subject to the Federal Advisory Committee Act (FACA)? Would the selection of the Board members be subject to FACA? Please explain.

3. Does NECA, its newly formed subsidiary, or the two unaffiliated corporations provide any budget information to Congress? If not, how is Congress informed of the operations of these entities? What, if any, oversight does the Congress have over these entities?

4. In the May 1997 Universal Service Order, the Commission determined that the universal service administrator should select a subcontractor to manage the applications process for schools and libraries. In the July 1997 NECA Governance Order, the Commission directed NECA to create an unaffiliated, not-for-profit corporation to manage the application and other processes relating to the administering the schools and libraries program. The Commission further directed NECA to create another unaffiliated, not-for-profit corporation to manage specified portions of the rural health care program. Please explain the new information and analysis that led to this change in the Commission's approach. Please include the names of the corporation and governance experts that the Commission spoke with and their views, the structural organizations that the Commission examined, and the analysis that led to the Commission's decision.

5. Section 254 required that the Commission initiate a single proceeding to implement the Joint Board's recommendations and to complete this proceeding within 15 months after the date of enactment of the Telecommunications Act of 1996. In view of this requirement, what is the authority of the Commission to (1) establish a new organizational structure for the provision of universal service and (2) to change the mandate of the permanent administrator in connection with the administration of the schools and libraries and rural health care programs. Did the public have an opportunity to comment on these changes? Please explain.

6. Does NECA, its subsidiary, or the two unaffiliated corporations have authority to operate outside of the Commission's orders? In other words, do these entities have the authority to operate independent from the direction and control of the Commission?

7. What will the Commission's relationship be with the permanent administrator? For example, will it be under contract? What is the status of the establishment of the FACA committee?

We have been informed by your staff, that in order for us to review material that is not on the public record, we would need to make a written request. As you are aware, each agency is required under 31 U.S.C. § 716 to comply with GAO's request for information concerning the duties, powers, activities, organization, and financial

transactions of the agency, and the GAO is authorized to inspect agency records to obtain such information. Please provide us with all analysis and information pertaining to the Commission's determination to direct NECA to establish a subsidiary and two unaffiliated corporations. This would include the legal review of the Commission's May and July orders; any internal memoranda; and any other pertinent information. Additionally, please provide us with any analysis and information that led to the creation of NECA in 1983.

In order to respond to Senator Steven's request, we will need your response by January 5, 1998, and the requested documents as soon as possible. If you have any questions, please contact Mrs. Mindi Weisenbloom (202 512-8271) or me (202 512-8236).

Sincerely yours,



Michael R. Volpe
Assistant General Counsel

cc: Suzanne M. Tetreault
Deputy Associate General Counsel

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GAO

Fax Transmittal Sheet

To: (Name and Address)

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Date 12/23/97

From: (Name and Address)

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Date

Subject:

Universal Service Order

Additional Information

Acknowledgement Requested

1. ☐ Yes ☒ No2. 4 pages, including this cover sheet, are being transmitted.3. If pages are not received, call 202 - 512 - 8236